Michigan Department of Treasury
496 (02/06)

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type	Local Unit Name	County
☐County ☐City ☐Twp ☐Village ☒Other	Lansing Board of Water and Light	Ingham

Fiscal Year End	Opinion Date	Date Audit Report Submitted to State
June 30, 2006	August 25, 2006	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

	YES	NO	**Check each applicable box below.** (See instructions for further detail.)
1.	☐	☒	All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2.	☒	☐	There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3.	☐	☒	The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4.	☒	☐	The local unit has adopted a budget for all required funds.
5.	☒	☐	A public hearing on the budget was held in accordance with State statute.
6.	☒	☐	The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7.	☒	☐	The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8.	☒	☐	The local unit only holds deposits/investments that comply with statutory requirements.
9.	☒	☐	The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10.	☒	☐	There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11.	☐	☒	The local unit is free of repeated comments from previous years.
12.	☒	☐	The audit opinion is UNQUALIFIED.
13.	☒	☐	The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14.	☒	☐	The board or council approves all invoices prior to payment as required by charter or statute.
15.	☒	☐	To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)
Financial Statements	☒	
The letter of Comments and Recommendations	☒	
Other (Describe)	☐	

Certified Public Accountant (Firm Name)	Telephone Number		
Plante & Moran, PLLC	517-332-6200		
Street Address	**City**	**State**	**Zip**
1111 Michigan Ave	East Lansing	MI	48823
Authorizing CPA Signature	**Printed Name**	**License Number**	
[signature]	Douglas D. Rober, CPA	22057	

Board of Water and Light - City of Lansing, Michigan

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Independent Auditor's Report

Honorable Mayor, Members of City Council,
and Commissioners of the
Board of Water and Light

We have audited the basic financial statements of the Board of Water and Light - City of Lansing, Michigan Enterprise Fund (the "BWL") as of and for the years ended June 30, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of the BWL's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 13 to the financial statements, the financial statements referred to above present only the Enterprise Fund of the BWL. The financial statements do not include financial data for the Board of Water and Light trust funds, which accounting principles generally accepted in the United States of America require to be reported with the financial data of the BWL's Enterprise Fund. As a result, these financial statements do not purport to, and do not, present fairly the financial position of the reporting entity of the BWL as of June 30, 2006 and 2005 and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Enterprise Fund of the BWL as of June 30, 2006 and 2005 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Honorable Mayor, Members of City Council,
and Commissioners of the
Board of Water and Light

The management's discussion and analysis on pages 3 through 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

As discussed in Note 15 to the financial statements, during the year ended June 30, 2006, the BWL elected for the early adoption of Governmental Accounting Standard Board (GASB) No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.*

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the BWL's basic financial statements. The additional information on pages 40 through 44 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Plante & Moran, PLLC

August 25, 2006

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This section explains the general financial condition and results of operations for the Lansing Board of Water and Light (the "BWL"). The BWL includes the consolidated operations of the water, electric, steam, and chilled water utilities. The notes to financial statements following this section are essential reading for a complete understanding of the financial and operational results for fiscal year 2006.

Overview of Business - The BWL owns and operates an electric system which generates, purchases, and distributes electric power and energy, and provides electric service to over 96,000 residential, commercial, and industrial customers in the Greater Lansing Area. The BWL generated 73 percent of its retail and wholesale sales from existing generation assets and purchased additional electric generation through its membership in the Michigan Public Power Agency's partial ownership of Detroit Edison's Belle River Plant.

The BWL owns and operates water wells, a raw water transmission system, water conditioning facilities, and an extensive water distribution system serving potable water to over 54,000 residential, commercial, and industrial customers in the Greater Lansing Area.

The BWL owns and operates steam generation boilers, a steam transmission and distribution system serving 250 customers, and a chilled water facility and distribution piping system serving 14 customers in the City of Lansing.

Capital Expenditures

Capital expenditures are driven by the need to expand or maintain the generation, transmission, and distribution systems of the BWL to meet growing customer utility needs and to maintain a satisfactory level of service reliability. The BWL invests essentially all revenues not paid out for operations and maintenance expense, non-operating expenses, or debt principal back into capital improvements for the water, electric, and steam systems. Gross capital expenditures were $42.5 million in fiscal year 2006 compared to $29 million in fiscal year 2005.

The BWL generally pays the major portion of the cost of its capital improvements from internally generated funds and a lesser portion from the proceeds of revenue bonds that are issued from time to time.

Detailed financial information for the separate utilities of water, electric, steam, and chilled water can be found in the additional information section beginning on page 40.

Condensed Financial Information (dollars in millions)

	June 30 2006	June 30 2005	Percentage Change
Assets			
Utility plant	$ 511.8	$ 524.1	(2.3)
Other assets	199.5	158.4	25.9
Total assets	711.3	682.5	4.2
Liabilities			
Long-term liabilities	193.8	174.3	11.2
Other liabilities	35.1	32.5	8.0
Total liabilities	228.9	206.8	10.7
Net Assets			
Invested in capital assets	351.0	357.6	(1.8)
Restricted for debt service	39.5	50.0	(21.0)
Unrestricted	91.9	68.1	34.9
Total net assets	$ 482.4	$ 475.7	1.4

Utility plant decreased by the net amount of $12.3 million. $12.1 million of this decrease was due to the impairment of the steam main serving GM plants.

Other assets increased by $41.1 million. $12.1 million was due to establishing the deferred debit for the impairment described in the previous paragraph. Other reasons for the increase include a $17.5 million increase in receivables due to GM termination fees, an $8.4 million increase in deferred environmental remediation costs, and a $3.7 million increase in receivables from the MPPA project fund.

Long-term liabilities increased $19.5 million due to the $17.5 million in deferred GM termination fee revenue and the $8.4 million increase in environmental remediation liability discussed in the previous paragraph. These were offset by the payment of annual principal debt obligations.

Invested in capital assets decreased $6.6 million due to the impairment write-off mentioned above less repayment of bonded debt.

The decrease in restricted for debt service is due primarily to a reduction in the balance of the Operating and Maintenance Cash fund.

Unrestricted equity increased $23.8 million due to a change in net assets of $6.7 million and the net result of the other changes mentioned above.

Condensed Financial Information (dollars in millions) (Continued)

	Year Ended June 30 2006	Year Ended June 30 2005	Percentage Change
Results of Operations			
Operating revenue	$ 233.6	$ 228.5	2.2
Operating expenses	236.3	220.0	7.4
Nonoperating income (expense) - Net	9.4	(1.4)	(771.4)
Change in Net Assets	**$ 6.7**	**$ 7.1**	**(5.6)**

Operating revenues increased $5.1 million primarily due to the recovery of increased purchased power and fuel costs via a rate surcharge. Rate increases of 3 percent in the electric utility and 6.5 percent in the water utility effective July 1, 2005, also contributed to increased revenue. These increases were offset by a $7.1 million decrease in Steam revenue driven by GM plant closings and also by a $2.4 million decrease in electric wholesale revenue.

Operating expenses increased $16.3 million due to a $3.5 million increase in fuel and purchased power, $7.0 million in increased retiree health care costs, and $2.0 million in increased maintenance expenses.

Nonoperating income (expenses) increased by $10.8 million due primarily to the sale of SO2 credits including credits held by MPPA. Revenue from SO2 credits increased $14.2 million from 2005 to 2006. This was offset by a reduced amount of interest earnings on funds held by MPPA which was $2.6 million lower in 2006 compared to 2005 interest earnings.

Income before capital contributions for the fiscal year June 30, 2006 was $6.7 million compared to $7.1 million for the previous year.

Budget - The BWL Commissioners approved a $221.9 million operating expense budget for fiscal year 2006. Actual expenses were $236.3 million or 6.5 percent more than budget. The increase was mainly due to increases in fuel and purchased power as well as increased retiree health care costs. The net capital improvement budget was $35.3 million for fiscal year 2006; actual net capital expenditures were $34.3 million or 97 percent of the capital budget.

Financing Activities - During fiscal year 2006, revenue bonds of $12,325,000 were issued to finance the advance refunding of a portion of the 1999A revenue bonds.

During fiscal year 2005, there were no significant financing activities.

The BWL is currently considering the issuance of additional revenue bonds in fiscal year 2007 to fund construction activities. The decision to issue the bonds will depend on future market conditions.

Other Significant Items - On December 27, 2005, General Motors Corporation ("GM") issued a termination notice on the Steam Service Agreement covering Plant #1 and the Plant #6 complex.

As a result of this termination notice, three separate termination clauses in the agreement were put into effect. These termination fees resulted in a $17.5 million receivable being recorded. As a consequence of GM issuing a termination notice and no longer taking steam service at several plants, the BWL has an impaired asset. This impaired asset resulted in a $12.1 million reduction to fixed assets. The BWL is utilizing FAS 71 treatment for the termination fees and the impaired asset to allow for these transactions to be reflected in future rates.

The determination of final amounts to be paid by GM as well as the timing of these payments is under discussion with GM.

	June 30	
	2006	2005
Assets		
Current Assets		
Restricted cash and cash equivalents (Notes 4 and 11)	$ 38,527,046	$ 50,439,953
Investments (Notes 1 and 11)	38,706,626	40,229,764
Accounts receivable - Net (Note 1)	34,560,021	24,466,935
Estimated unbilled accounts receivable (Note 1)	9,975,019	10,069,310
Inventories (Note 1)	15,504,795	11,940,961
Other	784,250	1,322,241
Total current assets	138,057,757	138,469,164
Other Assets		
Deferred energy cost (Note 6)	1,969,044	855,885
Deferred amortization of Central Utilities Complex (Note 6)	3,692,733	2,700,800
Deferred environmental remediation (Note 6)	13,023,000	4,623,000
Deferred asset impairment (Note 6)	12,157,037	-
GM steam service termination fees (Note 6)	17,542,491	-
Other	1,284,391	1,630,485
Total other assets	49,668,696	9,810,170
Noncurrent Restricted Assets (Notes 4 and 11)	11,762,593	10,121,212
Utility Plant (Note 1)		
Water	185,658,527	173,596,022
Electric	562,868,372	545,275,598
Steam	51,617,139	52,211,100
Chilled water	36,199,211	36,153,895
Common facilities	68,056,057	64,364,589
Central Utilities Complex	76,079,000	76,079,000
Total	980,478,306	947,680,204
Less accumulated depreciation	488,909,220	450,308,407
Total	491,569,086	497,371,797
Construction in progress (Note 3)	20,213,180	26,741,827
Total utility plant	511,782,266	524,113,624
Total assets	**$ 711,271,312**	**$ 682,514,170**

See Notes to Financial Statements.

	June 30	
	2006	2005
Liabilities and Net Assets		
Current Liabilities		
Accounts payable	$ 14,753,360	$ 13,513,638
Current portion of long-term debt (Note 5)	9,099,060	8,691,424
Accrued payroll and related taxes	960,083	1,341,754
Customer deposits	2,304,808	915,882
Accrued compensated absences (Note 1)	3,462,864	3,290,801
Accrued interest	4,473,865	4,760,448
Total current liabilities	35,054,040	32,513,947
Compensated Absences - Less current portion (Note 1)	7,225,634	7,342,328
Other Long-term Liabilities		
Workers' compensation	627,959	1,023,458
Environmental remediation liability	13,023,000	4,623,000
Deferred steam service termination fees (Note 6)	17,542,491	-
Arbitrage rebate requirement (Notes 4 and 12)	-	178,125
Other	1,951,599	1,668,777
Total other long-term liabilities	33,145,049	7,493,360
Long-term Debt - Less current portion (Note 5)	153,415,981	159,459,080
Total liabilities	228,840,704	206,808,715
Net Assets		
Invested in capital assets	350,982,876	357,613,276
Restricted for debt service (Note 4)	39,474,928	50,041,460
Unrestricted	91,972,804	68,050,719
Total net assets	482,430,608	475,705,455
Total liabilities and net assets	**$ 711,271,312**	**$ 682,514,170**

Board of Water and Light - City of Lansing, Michigan

Statement of Revenues, Expenses, and Changes in Net Assets

	Year Ended June 30 2006	Year Ended June 30 2005
Operating Revenues (Note 1)		
Water	$ 24,566,856	$ 22,926,679
Electric	195,969,348	185,571,401
Steam	8,352,271	15,417,432
Chilled water	4,710,920	4,590,671
Total operating revenues	233,599,395	228,506,183
Operating Expenses		
Production:		
Fuel, purchased power, and other operating expenses	120,521,530	116,956,631
Maintenance	21,419,482	19,377,525
Transmission and distribution:		
Operating expenses	7,910,435	7,207,118
Maintenance	7,626,854	7,651,885
Administrative and general	50,364,794	41,624,515
Depreciation and impairment (Note 1)	28,434,086	27,149,445
Total operating expenses	236,277,181	219,967,119
Operating Income (Loss)	(2,677,786)	8,539,064
Nonoperating Income (Expenses)		
Investment income	2,637,223	2,941,898
Other income	19,659,379	8,375,183
System capacity fee	9,381,224	9,330,849
Bonded debt interest expense	(8,933,133)	(9,434,106)
Amortization - Central Utilities Complex	(4,080,000)	(3,805,000)
Payment in lieu of taxes (Note 7)	(9,227,227)	(8,795,755)
Other interest expense	(34,527)	(18,106)
Total nonoperating income (expenses) - Net	9,402,939	(1,405,037)
Net Income (Changes in Net Assets)	6,725,153	7,134,027
Net Assets - Beginning of year	475,705,455	468,571,428
Net Assets - End of year	**$ 482,430,608**	**$ 475,705,455**

See Notes to Financial Statements.

	Year Ended June 30	
	2006	2005
Cash Flows from Operating Activities		
Cash from customers:		
Water	$ 25,651,339	$ 23,402,011
Electric	191,906,513	177,831,862
Steam	9,418,759	15,829,639
Chilled water	4,682,461	4,545,550
Total cash from customers	231,659,072	221,609,062
Cash paid to suppliers:		
Suppliers of coal, freight, and purchased power	(101,881,994)	(96,781,899)
Other suppliers	(65,571,621)	(55,516,344)
Total cash paid to suppliers	(167,453,615)	(152,298,243)
Cash paid to employees	(44,217,448)	(44,639,087)
Payment in lieu of taxes (Note 7)	(9,227,227)	(8,795,755)
Cash from customer deposits	1,388,926	36,590
Interest on customer deposits	(34,527)	(18,105)
Net cash provided by operating activities	12,115,181	15,894,462
Cash Flows from Capital and Related Financing Activities		
Proceeds from new borrowings	15,148,758	1,436,945
Planned, bonded, and annual construction	(33,331,698)	(28,665,457)
Principal payments on debt	(20,962,346)	(8,922,377)
System capacity fees	9,381,224	9,330,849
Interest on debt	(9,219,716)	(9,653,032)
Net cash used in capital and related financing activities	(38,983,778)	(36,473,072)
Cash Flows from Noncapital Financing Activities		
Proceeds from the sale of emissions allowances	8,297,226	251,376
Other	4,139,484	7,022,075
Net cash provided by noncapital financing activities	12,436,710	7,273,451
Cash Flows from Investing Activities		
Proceeds from the sale and maturity of investments	2,504,306	21,192,176
Interest received	2,637,223	2,941,898
Purchase of investments	(2,622,549)	(19,528,741)
Net cash provided by investing activities	2,518,980	4,605,333

See Notes to Financial Statements.

Statement of Cash Flows (Continued)

	Year Ended June 30	
	2006	2005
Net Decrease in Cash and Cash Equivalents	$ (11,912,907)	$ (8,699,826)
Cash and Cash Equivalents - Beginning of year	50,439,953	59,139,779
Cash and Cash Equivalents - End of year	**$ 38,527,046**	**$ 50,439,953**

Reconciliation of operating income (loss) to net cash provided by operating activities:

	Year Ended June 30	
	2006	2005
Operating income (loss)	$ (2,677,786)	$ 8,539,064
Adjustments to reconcile operating income (loss) to net cash from operating activities:		
Payment in lieu of taxes (Note 7)	(9,227,227)	(8,795,755)
Depreciation	28,434,086	27,149,445
Sewerage collection fees	1,018,790	1,101,731
Interest on customer deposits	(34,527)	(18,105)
(Increase) decrease in assets:		
Accounts receivable (Note 1)	(3,889,208)	(6,571,295)
Unbilled accounts receivable (Note 1)	94,291	(571,673)
Inventories	(3,563,834)	(1,119,682)
Customer deposits	1,388,926	36,590
Other	(229,074)	(1,687,425)
Increase (decrease) in liabilities:		
Accounts payable and other accrued expenses	1,030,114	(2,864,012)
Other and deferred costs	(229,370)	695,579
Total adjustments	14,792,967	7,355,398
Net cash provided by operating activities	**$ 12,115,181**	**$ 15,894,462**

See Notes to Financial Statements.

Note 1 - Significant Accounting Policies

Reporting Entity - The Board of Water and Light (the "BWL"), a related organization of the City of Lansing, Michigan (the "City"), is an administrative board established by the City Charter. The City Charter grants the BWL full and exclusive management of the water, steam, chilled water, and electric services of the City. The commissioners of the governing board are appointed by the mayor with approval of the City Council. The BWL provides water, steam, chilled water, and electric services to the City and surrounding townships. The governing board (Board of Commissioners) has the exclusive authority to set rates for the services provided. The financial statements include the financial activities of the water, steam, chilled water, and electric operations of the BWL. The BWL is exempt from taxes on income because it is a municipal entity.

Basis of Accounting - The BWL utilizes the accrual basis of accounting. In addition, the BWL follows the accounting and reporting requirements of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, which requires that the effects of the ratemaking process be recorded in the financial statements. Such effects primarily concern the time at which various items enter into the determination of net income in order to follow the principle of matching costs and revenues. Accordingly, the BWL records various regulatory assets and liabilities to reflect the regulator's actions (see Note 6). Management believes that the BWL meets the criteria for continued application of SFAS No. 71, but will continue to evaluate its applicability based on changes in the regulatory and competitive environment.

On July 1, 1994, the BWL adopted Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*. Under this Statement, the BWL elected to follow all SFAS statements issued after November 30, 1989 that do not conflict with GASB statements.

System of Accounts - The BWL's accounts are maintained substantially in accordance with the Uniform Systems of Accounts of the Federal Energy Regulatory Commission for its electric and steam systems and in accordance with the Uniform Systems of Accounts of the National Association of Regulatory Utility Commissioners for the water and chilled water systems. The chart of accounts dictates how the BWL classifies revenue and expense items in the statement of activities as operating and non-operating.

Cash and Cash Equivalents - The BWL considers demand deposits and current restricted funds, which consist of cash and highly liquid investments with an original maturity of 90 days or less, as cash and cash equivalents for financial statement purposes.

Note 1 - Significant Accounting Policies (Continued)

Investments - The BWL has established special purpose funds designated to meet anticipated operating requirements. These funds consist principally of commercial paper and United States government securities and are segregated as follows:

	Carrying Value	
	2006	2005
Designated purpose:		
Coal inventory fluctuation	$ 3,707,946	$ 3,688,886
Litigation, environmental, and uninsured losses	16,387,961	15,398,882
Future Belle River costs	15,530,147	18,136,853
Future water facilities	3,080,572	3,005,143
Total	$ 38,706,626	$ 40,229,764

Accounts Receivable - Accounts receivable are stated at net invoice amounts. A general valuation allowance is established based on an analysis of the aged receivables and historical loss experience. All amounts deemed to be uncollectible are charged to expense in the period that determination is made. Accounts receivable are not deemed uncollectible until they are approximately 270 days past due and have remained completely unpaid throughout the BWL's collection policy. The components of accounts receivable for 2006 and 2005 are as follows:

	2006	2005
Customer receivables	$ 14,259,086	$ 12,451,599
Sewerage collections	1,817,709	1,904,646
Combined sewer overflow - City of Lansing	637,296	605,707
MPPA receivable	16,120,917	6,310,478
Miscellaneous	2,625,013	4,094,505
Less allowance for doubtful accounts	(900,000)	(900,000)
Total	$ 34,560,021	$ 24,466,935

Note 1 - Significant Accounting Policies (Continued)

Inventories - Inventories are stated at weighted average cost and consist of the following at June 30:

	2006	2005
Coal	$ 7,037,711	$ 4,412,281
Materials and supplies	8,467,084	7,528,680
Total	$ 15,504,795	$ 11,940,961

Utility Plant - The utility plant is stated on the basis of cost, which includes expenditures for new facilities and those which extend the useful life of existing facilities and equipment. Expenditures for normal repairs and maintenance are charged to maintenance expense as incurred.

Depreciation of the utility plant is computed using the straight-line method based on estimated useful lives, except for depreciation related to the central utilities complex, which is computed in accordance with SFAS No. 71. The resulting provisions for depreciation in 2006 and 2005, expressed as a percentage of the average depreciable cost of the related assets, are as follows:

	Average Rate (Percent)	
	2006	2005
Classification of utility plant:		
Water	2.2	1.9
Electric	3.3	3.4
Steam	3.5	3.1
Chilled water	4.8	4.8
Common facilities	3.8	3.8
Central Utilities Complex	5.4	5.0

When units of property are retired, their costs are removed from the utility plant and charged to accumulated depreciation.

Accrued Compensated Absences - The BWL records a liability for estimated compensated absences that are attributable to services already rendered and that are not contingent on a specific event that is outside the control of the BWL and its employees. This liability is accrued as employees earn the rights to such benefits. The BWL estimates the total current and noncurrent portions of the liability to be $10,688,498 and $10,633,129 as of June 30, 2006 and 2005, respectively.

Note 1 - Significant Accounting Policies (Continued)

Capital Contributions - Capital contributions represent nonrefundable amounts received from customers for construction of a utility plant. Electric, water, steam, and chilled water contributions are credited against the related assets and will offset the depreciation of the related assets over the estimated useful life. This treatment is consistent with the BWL's ratemaking policy and is thus permitted under SFAS No. 71.

Net Assets - Equity is classified as net assets and displayed in three components:

- **Invested in Capital Assets** (net of related debt) - Consists of capital assets, net of accumulated depreciation, and reduced by the outstanding balances of any bonds that are attributable to the acquisition, construction, or improvement of those assets.

- **Restricted for Debt Service** - Consists of net assets with constraints placed on their use by revenue bond resolution.

- **Unrestricted** - All other net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

Unbilled Accounts Receivable and Revenue - Unbilled accounts receivable at June 30, 2006 represents the estimated amount of accounts receivable for services that have not been billed as of the balance sheet date. The amounts are a result of a timing difference between the end of the financial statement cycle (month end) and the billing cycle (various dates within the month for each billing period). Accordingly, the current year revenue from customers whose billing period ends after June 30 for services rendered prior to June 30 will be recognized in the current period.

Interutility Transactions - The water, electric, steam, and chilled water operations of the BWL bill each other for services provided, and these services are reported as revenue to the generating operation and expense to the consuming operation. Such internal billings aggregated $4,979,924 and $5,231,587 in 2006 and 2005, respectively, and are not eliminated in the statement of income.

Note 1 - Significant Accounting Policies (Continued)

Emissions Allowance - The Environmental Protection Agency has granted emission allowances to the BWL related to the emission of certain pollutants. No amounts are recorded at the date of the grant. The BWL estimates the allowances needed for future years. As appropriate, the BWL may purchase additional allowances or sell the estimated future excess allowances. The purchase and sale of allowances by emission type is accounted for separately and is not offset against transactions involving allowances of different emission types. Purchased allowances net of proceeds from the sale of related allowances are recorded as an asset and will be expensed during the applicable period. Proceeds from the sale of allowances are recognized as income at the time of sale.

The BWL recognized a gain of $14,501,104 and $251,375 as of June 30, 2006 and 2005, respectively, from the sale of allowances and has recorded an intangible asset of approximately $900,000 and $1,300,000 as of June 30, 2006 and 2005, respectively, for purchased allowances related to future periods.

Significant Customers - The BWL has one customer which accounts for approximately 10 percent and 13 percent of the BWL's total revenue for the years ended June 30, 2006 and 2005, respectively.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Note 2 - Rate Matters

Rates charged to customers are established solely by the governing board. The BWL has agreed to charge rates sufficient to meet certain requirements of the bond resolutions for the outstanding revenue bonds.

Note 3 - Construction in Progress

Construction in progress consists of projects for expansion or additions to the utility plant. The estimated additional cost to complete these projects, based on the BWL's capital budget, approximates $11,567,000 at June 30, 2006, including commitments on existing construction contracts approximating $1,583,000. These projects will be funded through operational cash flow and a bond issuance, including the project funds reported as other assets.

Note 4 - Restricted Assets

Restricted assets are required under the 1994B, 1999A, 1999B, 2002A, 2002B, 2003A, and 2005A Revenue Bond resolutions and the related Nonarbitrage and Tax Compliance Certificates. These assets, which consist of cash, certificates of deposit, commercial paper, and United States government securities, are segregated into the following funds:

	Required at June 30, 2006	Carrying Value 2006	Carrying Value 2005
Current:			
Operations and Maintenance Fund	$ 18,081,100	$ 24,289,384	$ 36,616,865
Bond and Interest Redemption Fund	13,100,050	14,237,662	13,823,088
Total current	31,181,150	38,527,046	50,439,953
Noncurrent:			
2001A Construction Fund	1,715,651	1,715,651	1,650,156
Bond Reserve Fund	9,916,541	9,868,817	8,417,540
Rebate Fund	178,125	178,125	53,516
Total noncurrent	11,810,317	11,762,593	10,121,212
Total	$ 42,991,467	$ 50,289,639	$ 60,561,165

The restrictions of the various funds are as follows:

- **Operations and Maintenance Fund** - By the end of each month, this fund shall include sufficient funds to provide for payment of the succeeding month's expenses.

- **Bond and Interest Redemption Fund** - Restricted for payment of the current portion of bond principal and interest and the remaining capitalized interest on the 1994B, 1999A, 1999B, 2002A, 2002B, 2003A, and 2005A Revenue Bonds.

- **2001A Construction Fund** - Restricted for payment of costs of the 2001A bonded projects and costs of issuance of the 2001A Revenue Bonds.

Note 4 - Restricted Assets (Continued)

- **Bond Reserve Fund** - Shall include sufficient funds to cover the maximum annual principal and interest requirements for the outstanding 1994B, 1999A, and the uninsured portion of the 2002A, 2002B, 2003A, and 2005A Revenue Bonds. The Nonarbitrage and Tax Compliance Certification stipulates that the amount in the fund shall be valued at amortized cost to meet this requirement. As of June 30, 2006 the cost basis in the fund was $10,160,337.

- **Rebate Fund** - Shall include sufficient funds to enable the BWL to rebate arbitrage investment earnings to the federal government in accordance with Section 148(f)(2) of the Internal Revenue Code (IRC) of 1986, as amended (see Note 12).

Note 5 - Long-term Debt

Long-term debt as of June 30 consists of the following:

	2006	2005
Water Supply, Steam, and Electric Utility System Revenue Bonds, Series 2005A, due serially beginning July 1, 2011 and continuing through July 1, 2014, plus interest at rates ranging from 4.00% to 5.00%	$ 12,325,000	$ -
Water Supply, Steam, and Electric Utility System Revenue Bonds, Series 2003A, due serially through July 1, 2026, plus interest at rates ranging from 2.75% to 5.00%	29,030,000	29,390,000
Water Supply, Steam, and Electric Utility System Revenue Bonds, Series 2002A, due serially through July 1, 2018, plus interest at rates ranging from 3.50% to 5.00%	23,080,000	23,410,000
Water Supply, Steam, and Electric Utility System Revenue Refunding Bonds, Series 2002B, due serially through July 1, 2013, plus interest at rates ranging from 3.00% to 3.75%	16,845,000	18,625,000

Note 5 - Long-term Debt (Continued)

	2006	2005
Water Supply, Steam, and Electric Utility System Revenue Bonds, Series 1999B, due serially through July 1, 2016, plus interest at rates ranging from 7.30% to 7.70%	$ 63,564,000	$ 67,369,000
Water Supply, Steam, and Electric Utility System Revenue Bonds, Series 1999A, due serially through July 1, 2011, plus interest at rates ranging from 4.75% to 5.50%	11,000,000	25,270,000
Water Supply and Electric Utility System Revenue Bonds, Series 1994B, due serially through July 1, 2008, plus interest at rates ranging from 4.60% to 5.00%	971,000	971,000
Promissory note, due to the City of Lansing in semi-annual installments through October 1, 2024, plus interest at 2.50%	3,746,596	2,536,568
Promissory note, due in monthly installments of $9,492, including interest at 4.344%, with final payment December 30, 2008	294,951	369,209
Promissory note, due in monthly installments of $3,923, including interest at 4.944%, with final payment October 2006	15,963	60,627
Promissory note, due in monthly installments of $15,833, including interest at 4.889%, with final payment September 2008	405,363	569,870
Township contract water service obligation with interest due semi-annually at 6% and portions of principal due annually with final payment May 2015	279,980	374,837
Delta Township Drain Assessment due serially through January 15, 2025, plus interest at 5.25%	1,616,232	-
Total	163,174,085	168,946,111

Note 5 - Long-term Debt (Continued)

	2006	2005
Less current portion	$ (9,099,060)	$ (8,691,424)
Less current portion of premium/deferred amount of refunding on bonds	(115,177)	(117,553)
Plus unamortized premium	1,583,377	882,672
Deferred loss on refunding of bonds	(2,127,244)	(1,560,726)
Total long-term portion	$ 153,415,981	$ 159,459,080

The fair value of the long-term debt based on the quoted market prices for similar issues for debt of the same remaining maturities is estimated to be $171,402,021 and $186,537,400 at June 30, 2006 and 2005, respectively.

The unamortized premium and deferral on refunded bonds is being amortized over the life of the bonds, using the effective-interest method.

Aggregate annual principal payments applicable to long-term debt are as follows:

	Principal	Interest	Total
2007	$ 9,099,060	$ 8,929,836	$ 18,028,896
2008	9,612,481	8,463,061	18,075,542
2009	9,989,179	7,919,067	17,908,246
2010	10,487,115	7,337,575	17,824,690
2011	11,062,804	6,718,689	17,781,493
2012-2016	61,238,357	22,773,243	84,011,600
2017-2021	35,938,154	6,551,957	42,490,111
2022-2026	12,960,526	2,244,734	15,205,260
2027	2,786,409	67,750	2,854,159
Total	$ 163,174,085	$ 71,005,912	$ 234,179,997

Resolutions of the 1994B and 1999A bonds and the uninsured portion of the 2002A, 2002B, 2003A, and 2005A bonds require the BWL to establish a reserve account equal to the highest annual principal and interest requirements of such issues. As of June 30, 2006, the balance of this reserve account was $9,868,817 (Note 4) satisfying these requirements. The reserve requirements for the 1999B bonds and a portion of the 2002B bonds are satisfied by the purchase of a debt service reserve fund surety bond.

Note 5 - Long-term Debt (Continued)

All Water Supply and Electric Utility System Revenue Bonds were issued by authority of the BWL. Except for the Series 1999B Subordinate Lien Revenue Bonds, these bonds were issued on a parity basis and are payable solely from the net revenue of combined water, electric, and steam operations of the BWL.

During the fiscal year ended June 30, 2006, the BWL issued $12,325,000 of Water Supply, Steam, and Electric Utility System Revenue Refunding Bonds Series 2005A with an average interest rate of 4.9 percent; the proceeds were used to partially refund $12,345,000 of Series 1999A Water Supply, Steam, and Electric Utility System Revenue Bonds with an average interest rate of 5.3 percent. There was an economic loss of $14,359 to the BWL. The deferred loss on refunding is the difference between the reacquisition price of $13,255,956 and the net carrying amount of the old bonds of $12,345,000. The net deferred amount on refunding of $910,956 is being amortized using the effective-interest method over the life of the old bonds. The proceeds of the new bonds were placed in an escrow deposit fund to provide for all future debt service payments on the old bonds. Accordingly, the escrow deposit fund assets and the liability for the defeased bonds are not included in the financial statements. The outstanding balance of all defeased liabilities is $36,380,000 at June 30, 2006.

The BWL may redeem certain outstanding Water Supply and Electric Utility System Revenue Bonds prior to maturity. The Series 2005A Bonds maturing in the years 2011 to 2014, inclusive, shall not be subject to redemption prior to maturity.

The Series 2003A Bonds maturing in the years 2004 to 2013, inclusive, shall not be subject to redemption prior to maturity. Series 2003A Bonds due on or after July 1, 2014 to 2026, inclusive, shall be subject to redemption prior to maturity, at the option of the BWL, in such order of maturity as the BWL may determine, and by lot within any maturity, in whole or in part, on any date on or after July 1, 2013, at par plus accrued interest to the date fixed for redemption.

The Series 2002A Bonds maturing in the years 2003 to 2012, inclusive, and the Series 2002B Bonds shall not be subject to redemption prior to maturity. Series 2002A Bonds due on or after July 1, 2013, shall be subject to redemption prior to maturity, at the option of BWL, in such order of maturity as the BWL may determine, and by lot within any maturity, in whole or in part, on any date on or after July 1, 2012, at par plus accrued interest to the date fixed for redemption.

Note 5 - Long-term Debt (Continued)

The Series 1999B Bonds maturing in the years 2002 to 2009, inclusive, shall not be subject to redemption prior to maturity. Series 1999B Bonds due on or after July 1, 2010, shall be subject to redemption prior to maturity, at the option of the BWL, in such order of maturity as the BWL may determine, and by lot within any maturity, in whole or in part, on any date on or after July 1, 2009, at par plus accrued interest to the date fixed for redemption. In addition, there was a special optional redemption on January 1, 2003, for all series 1999B Bonds from unexpended series 1999B Bond proceeds on hand as of November 1, 2002, if any, at a price of 101 percent of their par value plus accrued interest, if any, to the date of redemption.

The Series 1999A Bonds maturing in the years 2001 to 2009, inclusive, shall not be subject to redemption prior to maturity. Series 1999A Bonds due on or after July 1, 2010, shall be subject to redemption prior to maturity, at the option of BWL, in such order of maturity as the BWL may determine, and by lot within any maturity, in whole or in part, on any date on or after July 1, 2009, at par plus accrued interest to the date fixed for redemption. During the year ended June 30, 2006 Series 1999A Bonds in the amount of $12,345,000 were defeased and this portion of the bond payable was removed from the BWL.

The Series 1994B Bonds are noncallable.

The long-term debt activity for the year ended June 30, 2006 is as follows:

	Compensated Absences	Revenue Bonds	Other Notes	Total
Beginning balance	$ 10,633,129	$ 164,239,392	$ 3,911,111	$ 178,783,632
Additions	172,212	12,345,000	2,980,497	15,497,709
Reductions	(116,843)	(20,428,436)	(532,523)	(21,077,802)
Ending balance	$ 10,688,498	$ 156,155,956	$ 6,359,085	$ 173,203,539
Due within one year	$ 3,462,864	$ 8,630,000	$ 469,060	$ 12,561,924

Note 6 - Deferred Costs/Credits Recoverable in Future Years

The BWL accounts for amortization of its central utilities complex ("CUC"), which is a separate operating unit of the BWL, under SFAS No. 71. The BWL has recorded deferred amortization of $3,692,733 and $2,700,800 at June 30, 2006 and 2005, respectively. Under an agreement with a BWL customer, the bonded debt related to the construction of the CUC will be reimbursed through payments to be received from this customer through 2017. The deferred amortization balance represents the difference between calculated straight-line amortization expense and the reimbursement payments received from the customer at year end.

Effective for the year ended June 30, 2004, SFAS No. 71 was used in accounting for expenses to be incurred and the estimated liability for environmental remediation of a landfill site operated by the BWL. A regulatory asset of $4,623,000 was created as a result. The BWL reviews the adequacy of its rates to recover its cost of service on an annual basis. Recovery of this regulatory asset will be considered in the next annual review and will be included in subsequent rates. During the year ended June 30, 2006, an additional SFAS No. 71 amount was approved by the Board of Commissioners to defer an additional $8,400,000 for the estimated liability of an environmental remediation for a second landfill.

During the year ended June 30, 2005, the Board of Commissioners approved the use of SFAS No. 71 in accounting for the BWL's energy cost adjustment ("ECA"). The ECA adjusts the amount to be billed to retail electricity customers to reflect the difference between the BWL's actual energy cost and the amounts incorporated into electricity rates. This resulted in deferred energy costs of $1,969,044 and $855,885 at June 30, 2006 and 2005, respectively. This amount represents costs to be recovered from customers in future years because actual costs of providing electricity were higher than the costs incorporated into BWL's electricity rates.

During the year ended June 30, 2006, the Board of Commissioners approved the use of SFAS No. 71 in accounting to defer certain General Motors Corporation ("GM") termination fees and related steam asset impairment. GM issued a termination notice on the Steam Service Agreement covering Plant #1 and the Plant #6 complex. As a result of this termination notice, three separate termination clauses in the Agreement were put into effect. These termination fees resulted in a $17,542,491 receivable being recorded. As a consequence of GM issuing a termination notice and no longer taking steam service at several plants, the BWL has an impaired asset. This impaired asset resulted in a $12,157,036 reduction to fixed assets. These fees are currently being discussed with GM and are not due for 3 ½ years. The BWL has decided to defer these fees and related asset impairment until they are included in the steam rates.

Note 7 - Transactions with the City of Lansing, Michigan

Operations - The BWL recognized revenue of $5,888,082 and $5,098,587 in 2006 and 2005, respectively, for water, electric, and steam services provided to the City. The BWL incurred expenses for sewerage services purchased from the City of $418,670 and $356,781 in 2006 and 2005, respectively.

Additionally, the BWL bills and collects sewerage fees for the City. In connection with these services, the BWL received sewerage collection fees of $1,107,759 and $1,101,732 in 2006 and 2005, respectively, included in other income.

Payment in Lieu of Taxes - Effective July 1, 1992, the BWL entered into an agreement with the City to provide an annual payment of a return on equity in accordance with a formula based on net billed retail sales from its water, steam heat, and electric utilities for the preceding 12-month period ending May 31 of each year. Effective March 1, 2002 and ending June 30, 2012, the formula to calculate the amount owed to the City for payment in lieu of taxes will also include revenue generated from the BWL's sales for resale on its water, steam heat, and electric utilities for the preceding 12-month period ending May 31 of each year. Subject to the provisions of Act 94 Public Acts of 1933, as amended, and the BWL's various bond covenants, this amount is payable to the City no later than June 30 of each year. Under terms of this agreement, the BWL paid to the City $9,227,227 in 2006, and $8,795,755 in 2005, of operational cash flow in excess of debt service requirements.

Note 8 - Retirement Plans

The BWL has two retirement plans. The BWL administers a tax-qualified, single-employer, noncontributory, defined benefit public employee retirement pension plan (the "Defined Benefit Plan"), and the BWL has a tax-qualified, single-employer, noncontributory, defined contribution public employee retirement pension plan (the "Defined Contribution Plan").

Defined Benefit Plan

The defined benefit plan was established by the BWL in 1939 under Section 5-203 of the City Charter and has been revised several times, with the latest revision taking effect on November 19, 2002.

Note 8 - Retirement Plans (Continued)

The Defined Benefit Plan, by resolution of the Board of Commissioners, was closed to employees hired subsequent to December 31, 1996, and a Defined Contribution Plan was established for employees hired after December 31, 1996. Effective December 1, 1997, all active participants in the Defined Benefit Plan were required to make an irrevocable choice to either remain in the Defined Benefit Plan or move to the newly established Defined Contribution Plan. Those participants who elected to move to the Defined Contribution Plan received lump-sum distributions from the Defined Benefit Plan, which were rolled into their accounts in the new Defined Contribution Plan. Of the 760 employees who were required to make this election, 602 elected to convert their retirement benefits to the newly established Defined Contribution Plan.

The Plan for Employees' Pensions of the Board of Water and Light - City of Lansing, Michigan - Defined Benefit Plan issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Board of Water and Light, Senior Vice President of Finance and Administration, P.O. Box 13007, Lansing, Michigan 48901-3007.

A participant's interest is fully vested when the participant has been credited with seven years of vesting service. The Defined Benefit Plan provides for an annual benefit upon normal retirement equal to the total number of years of credited service multiplied by 1.8 percent of the highest annual pay during the last 10 years of service, paid in equal monthly installments.

Effective July 1, 1999, the Defined Benefit Plan was amended to include a medical-benefit component, in addition to the normal retirement benefits, to fund a portion of the postretirement obligations for certain retirees and their beneficiaries. The funding of the medical benefit component is limited to the amount of excess pension plan assets available for transfer, as determined by the actuary. For the year ended June 30, 2005, these amounts totaled $5,519,258. During the year ended June 30, 2006, medical benefits paid by the Defined Benefit Plan totaled $1,213,612.

Basis of Accounting - The Defined Benefit Plan's financial statements are prepared using the accrual basis of accounting. Benefits are recognized when due and payable in accordance with the terms of the Defined Benefit Plan.

Investment Valuation and Income Recognition - The Defined Benefit Plan investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price. Investments that do not have an established market are reported at estimated fair values.

Note 8 - Retirement Plans (Continued)

Funding Policy and Annual Pension Cost - The BWL's funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are designed to accumulate sufficient assets to pay benefits when due. The normal cost and amortization payment for the years ended June 30, 2006, 2005, and 2004, were determined using an attained age projected unit credit actuarial funding method. No transition adjustments were required upon implementation of Governmental Accounting Standards Board No. 27, *Accounting for Pensions by State and Local Government Employers*. Overfunded actuarial accrued liabilities were amortized as a level dollar reduction of contributions over a period of 15 years in 2006, 2005, and 2004.

The annual pension cost was determined as part of an actuarial valuation of the Defined Benefit Plan as of February 28, 2006, February 28, 2005, and February 29, 2004. Significant actuarial assumptions used in determining the annual pension cost include (a) rate of return on the investment of present and future assets of 7.5 percent in 2006, 2005, and 2004, compounded annually, (b) projected salary increases ranging from 5.0 to 11.0 percent in 2006, 2005, and 2004, compounded annually, depending on age, attributable to inflation, and (c) the assumption that benefits will not increase after retirement.

Employer contributions were made in accordance with contribution requirements determined by an actuarial valuation of the Defined Benefit Plan and consisted of the following:

	2006	2005	2004
Normal cost	$ 585,429	$ 688,293	$ 762,292
Amortization of the overfunded actuarial accrued liability	(4,461,028)	(4,983,145)	(4,859,003)

Note 8 - Retirement Plans (Continued)

Based on the overfunded status of the Defined Benefit Plan, no employer contributions are required.

Schedule of Funding Progress (Unaudited - Required Information)
(Dollar amounts in thousands)

Valuation Date	Actuarial Asset Values	AAL	UAAL	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
February 29, 2004	$ 136,898	$ 89,612	$ (47,286)	153	$ 4,788	(987.6)
February 28, 2005	128,891	86,560	(42,331)	149	4,142	(1,022.0)
February 28, 2006	125,630	86,906	(38,724)	145	3,942	(982.3)

AAL - Actuarial Accrued Liability (Projected Unit Credit Accrued Liability)

UAAL - Unfunded Actuarial Accrued Liability, negative UAAL indicates a funding excess

Three-year Trend Information - Assets available at market; actuarial accrued liability - projected unit cost method (AAL); unfunded actuarial accrued liability (UAAL) and negative UAAL indicates a funding excess.

(Dollar amounts in thousands)

Fiscal Year Ended	Assets Available	AAL	UAAL	Funded Ratio
June 30, 2004	$ 126,728	$ 89,612	$ (37,116)	141
June 30, 2005	120,015	86,560	(33,455)	139
June 30, 2006	121,119	86,906	(34,213)	139

Defined Contribution Plan

The Defined Contribution Plan was established by the BWL in 1997 under Section 5-203 of the City Charter. The Defined Contribution Plan covers substantially all full-time employees hired after December 31, 1996. In addition, 602 employees hired before January 1, 1997 elected to convert their retirement benefits from the Defined Benefit Plan effective December 1, 1997.

Note 8 - Retirement Plans (Continued)

The Plan for Employees' Pensions of the Board of Water and Light - City of Lansing, Michigan - Defined Contribution Plan issues a publicly available financial report. That report may be obtained by writing to the Board of Water and Light, Senior Vice President of Finance and Administration, P. O. Box 13007, Lansing, Michigan 48901-3007.

The Defined Contribution Plan operates as a money purchase pension plan and meets the requirements of Sections 401(a) and 501(a) of the IRC of 1986, as amended from time to time.

For employees hired before January 1, 1997, the BWL is required to contribute 15.0 percent of the employees' compensation. For employees hired after January 1, 1997, the BWL is required to contribute 8.1 percent of the employees' compensation. In addition, the BWL is required to contribute 3.0 percent of the employees' compensation for all employees who are not eligible to receive overtime pay and 0.5 percent of the employees' compensation for all nonbargaining employees.

During the years ended June 30, 2006 and 2005, the BWL contributed $4,983,456 and $5,319,172, respectively. The BWL contributions are recognized in the period that the contributions are due.

Retiree Benefit Plan and Trust

The Retiree Benefit Plan and Trust (the Plan) is a single-employer defined benefit healthcare plan. The Plan provides medical, dental, and life insurance benefits in accordance with Section 5-203 of the City Charter. Substantially all of the BWL's employees may become eligible for health care benefits and life insurance benefits if they reach normal retirement age while working for the BWL. There were 661 participants eligible to receive benefits at June 30, 2006, and 641 participants eligible at June 30, 2005.

In October 1999, the BWL formed a Voluntary Employee Benefit Administration (VEBA) trust for the purpose of accumulating assets sufficient to fund retiree health care insurance costs in future years. During the years ended June 30, 2006 and 2005, the BWL contributed $10,216,312 and $7,219,258, respectively, to the VEBA trust.

The Retiree Benefit Plan and Trust of the Board of Water and Light - City of Lansing, Michigan issues a publicly available financial report. That report may be obtained by writing to the Board of Water and Light, Senior Vice President of Finance and Administration, P. O. Box 13007, Lansing, Michigan 48901-3007.

Note 8 - Retirement Plans (Continued)

Funding Policy - The Board adopted a process for funding the retiree benefits using both a VEBA trust and, to the extent permitted by law, excess pension assets in the Defined Benefit Pension Plan. Additional contributions to the VEBA Trust from BWL operating funds to supplement Section 420 transfers will not exceed the recommended annual contribution amount required to cover current service of active participants and amortize the unfunded accrued liability over 30 years. The required contribution is based on a projected pay-as-you-go financing requirement with an additional amount to prefund benefits.

The Board's annual other postemployement benefit (OPEB) cost is calculated based on the annual required contribution (ARC) an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities over a period of 30 years.

Fiscal Year Ended	Annual OPEB Cost (in 000's)	Annual OPEB Contributed (in 000's)	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
06/30/06	$ 17,265	$ 17,265	100%	$ -

Funded Status and Funding Progress - As of February 28, 2006, the most recent actuarial valuation date, the plan was 17.4 percent funded. The actuarial accrued liability for benefits was $216,161,111, and the value of assets was $37,664,304, resulting in an unfunded actuarial accrued liability (UAAL) of $178,496,807.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Significant actuarial assumptions used in determining the annual OPEB cost include (a) rate of return on the investments of present and future assets of 7.5 percent, compounded annually, (b) projected salary increases ranging from 5.0 to 11.0 percent, depending on age, and (c) amortization method level dollar over a 30-year period.

Valuation Date	Actuarial Asset Value	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio
02/28/06	$ 37,664,304	$ 216,161,111	$ (178,496,807)	17.40%

Note 8 - Retirement Plans (Continued)

Other Postretirement Benefits

In addition to providing pension benefits, the BWL provides certain hospitalization, dental, and life insurance benefits for retired employees. Fifty percent of the cost of life insurance benefits will be paid by bargaining unit employees. The hospitalization and dental benefits are provided through an insurance company whose premiums are based on the benefits paid during the year. Effective July 1, 1999, the Defined Benefit Plan was amended to include a medical-benefit component, in addition to the normal retirement benefits, to fund a portion of the postretirement obligations for certain retirees and their beneficiaries. The funding of the medical-benefit component is limited to the amount of excess pension plan assets available for transfer, as determined by the actuary. For the year ended June 30, 2006, the total cost of providing such benefits was $7,049,128 of which $1,213,612 was funded by the Defined Benefit Plan of the BWL, and the remainder was funded by the BWL. For the year ended June 30, 2005, the total cost of providing such benefits was $6,351,118 of which $5,219,258 was funded by the Defined Benefit Plan of the BWL, and the remainder was funded by the BWL. The BWL offers its employees a deferred compensation plan, created in accordance with IRC 457, that is administered by a Trustee, the ICMA Retirement Corporation. The BWL makes contributions of $1,000 annually for the employees as of January 1 of each year, during the month of January. The BWL also will match employee contributions after employees contribute $1,000 at a rate of 75 percent until they reach the maximum of an additional $500 in contributions.

Note 9 - Commitments and Contingencies

At June 30, 2006, the BWL has unused letters of credit in the amounts of $817,220 and $1,000,000, issued to the Michigan Department of Natural Resources. The letters of credit were issued to satisfy requirements of the Michigan Department of Natural Resources to provide financial assurance to the State of Michigan for the cost of closure and postclosure monitoring and maintenance of a landfill site operated by the BWL.

Through monitoring tests performed on the landfill sites operated by the BWL, it has been discovered that the sites are contaminating the groundwater. The contamination does not pose a significant health risk, but does lower the quality of the groundwater. The BWL is currently in the process of applying for approval from the State of Michigan to remediate the sites. The BWL has estimated the total cost for remediation of the landfills and has recorded the liability of $13,023,000 and $4,623,000, for the years ended June 30, 2006 and 2005, respectively. In accordance with SFAS No. 71 (see Note 1), the BWL recorded a corresponding regulatory asset (see Note 6).

Note 9 - Commitments and Contingencies (Continued)

The BWL had previously announced a program to upgrade existing lead pipes throughout the BWL service area over the course of approximately 11 years at a cost of approximately $30,000,000.

The BWL is subject to various laws and regulations with respect to environmental matters such as air and water quality, soil contamination, solid waste disposal, handling of hazardous materials, and other similar matters. Compliance with these various laws and regulations could result in substantial expenditures. The BWL has established a Designated Purpose Fund (see Note 1) of which one of the purposes of the fund is to meet extraordinary expenditures resulting from responsibilities under environmental laws and regulations. Management believes that all known or expected responsibilities to these various laws and regulations by the BWL will be sufficiently covered by the Designated Purpose Fund and the environmental remediation liability.

The BWL is involved in various other legal actions, which have arisen in the normal course of business. Such actions are usually brought for claims in excess of possible settlement or awards, if any, that may result. After taking into consideration legal counsel's evaluation of pending actions, management has recorded an adequate reserve as of June 30, 2006 in regard to specific pending legal cases.

The BWL has entered into contracts to purchase coal totaling approximately $28,140,000 through December 31, 2006. In addition, the BWL has entered into contracts for the rail services related to shipping the coal. Commitments for future rail services to be purchased are approximately $64,400,000 through December 2008.

The BWL has entered into agreements for other operating activities totaling approximately $3,692,602 through December 31, 2007.

Note 10 - Power Supply Purchase

In 1983, the BWL entered into 35-year power supply and project support contracts with the Michigan Public Power Agency (MPPA), of which the BWL is a member. Under the agreement, the BWL has the ability to purchase power from MPPA, will sell power to MPPA at an agreed-upon rate, and will purchase 64.29 percent of the energy generated by MPPA's 37.22 percent ownership in Detroit Edison's Belle River Unit #1 (Belle River), which became operational in August 1984.

Note 10 - Power Supply Purchase (Continued)

Under the terms of its contract, the BWL must make minimum annual payments equal to its share of debt service and its share of the fixed operating costs of Belle River. The estimated required payments presented below assume no early calls or refinancing of existing revenue bonds and a 3.0 percent annual inflation of fixed operating costs, which include expected major maintenance projects.

Year	Debt Service	Estimated Fixed Operating	Total Required
2007	$ 17,674,811	$ 9,308,507	$ 26,983,318
2008	17,675,124	9,587,762	27,262,886
2009	17,677,776	9,875,395	27,553,171
2010	17,667,701	10,171,656	27,839,357
2011	17,675,483	10,476,806	28,152,289
2012 - 2016	88,382,107	57,291,649	145,673,756
Total	$ 176,753,002	$ 106,711,775	$ 283,464,777

In addition to the above required payments, the BWL must pay for fuel, other operating costs, and transmission costs related to any kilowatt hours (KWHs) purchased under these contracts.

The BWL recognized expenses for 2006 and 2005 of $45,782,347 and $43,464,342, respectively, to purchase power under the terms of this contract. The price of this power was calculated on a basis, as specified in the contracts, to enable MPPA to recover its production, transmission, and debt service costs.

In connection with the Belle River purchase, in December 2002, MPPA issued $280,180,000 principal amount of its Belle River Project Refunding Revenue Bonds, 2002 Series A, with rates ranging from 2.125 percent to 5.25 percent to advance refund $330,850,000 outstanding 1993A and B bonds.

During the year ended June 30, 2005, the BWL submitted a five-year termination notice of its participation in the MPPA Power Pool Project, terminating, as of December 31, 2010, the BWL's contractual obligation to buy and sell power within the Pool. The termination notice does not extinguish the BWL's membership in MPPA and causes no change in BWL's contractual obligations to MPPA related to Belle River.

Note 11 - Cash, Investments, and Fair Value Disclosure

During the year ended June 30, 2005, the BWL adopted GASB No. 40, *Deposit and Investment Risk Disclosures*. The modified disclosures required by GASB No. 40 are reflected below.

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; certificates of deposit, savings accounts, deposit accounts, or depository receipts of an eligible financial institution; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which mature not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The operating cash investment policy adopted by the BWL in accordance with Public Act 20, as amended, and the Lansing City Charter has authorized investment in bonds and securities of the United States government, certificates of deposit, time deposits, and bankers' acceptances of qualified financial institutions, commercial paper rated A1 by Standard and Poor's and P1 by Moody's, repurchase agreements using any of these securities, and liquid asset accounts managed by a qualified financial institution using any of these securities. The BWL's deposits and investment policies are in accordance with statutory authority.

The BWL's cash and investments are subject to several types of risk, which are examined in more detail below:

Risks at June 30, 2006

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the BWL's deposits may not be returned to it. The BWL requires that financial institutions must meet minimum criteria to offer adequate safety to the BWL. At year end, the BWL had $3,485,384 of bank deposits that were uninsured and uncollateralized. The BWL believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the BWL evaluates each financial institution with which it deposits funds and only those institutions meeting minimum established criteria are used as depositories.

Note 11 - Cash, Investments, and Fair Value Disclosure (Continued)

Custodial Credit Risk of Investments - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the BWL will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The BWL does not have a policy for custodial credit risk. At year end, the following investment securities were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent, but not in the BWL's name:

Type of Investment	Carrying Value	How Held
U.S. government or agency bond or notes	$ 28,487,186	Counterparty

Interest Rate Risk - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The BWL's investment policy restricts investment maturities to a maximum maturity of three years. At year end, the average maturities of investments are as follows:

	Fair Value	Less than 1 Year	1-5 Years
Pooled investment funds (if not 2a-7)	$ 18,541,244	$ 18,541,244	$ -
U.S. government or agency bond or note	27,277,861	4,971,437	20,486,494
Commercial paper	35,806,788	35,806,788	-

Credit Risk - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The BWL investment policy further limits its investment in commercial paper to prime quality by both Standard and Poor's and Moody's (A1/P1). As of year end, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Rating Organization
Pooled investment funds	$ 18,541,244	AAA	S&P
	4,997,480	Not rated	Not rated
Commercial paper	20,388,863	A1 +	S&P
	11,359,869	A1	S&P
	4,058,055	P1	Moody's

Note 11 - Cash, Investments, and Fair Value Disclosure (Continued)

Concentration of Credit Risk - The BWL's investment policy allows no more than 30 percent of the total portfolio to be invested in obligations of any particular issuer except the U.S. Treasury. As of year end, more than 5 percent of the BWL's investments are in various commercial paper as listed below. These investments represent 13.54 percent of the BWL's total investments.

Issuer	Amount Invested	Percentage of Total Investments
American Express Credit commercial paper	$ 6,570,054	7.58
General Electric Capital commercial paper	5,166,744	5.96

Foreign Currency Risk - The BWL policy requires that all investments be in U.S. dollars. The BWL holds no investments in foreign entities, currency, or debt.

__Risks at June 30, 2005__

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the BWL's deposits may not be returned to it. The BWL requires that financial institutions must meet minimum criteria to offer adequate safety to the BWL. At year end, the BWL had $4,539,211 of bank deposits that were uninsured and uncollateralized. The BWL believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the BWL evaluates each financial institution with which it deposits funds and only those institutions meeting minimum established criteria are used as depositories.

Custodial Credit Risk of Investments - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the BWL will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The BWL does not have a policy for custodial credit risk. At year end, the following investment securities were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent, but not in the BWL's name:

Type of Investment	Carrying Value	How Held
U.S. government or agency bond or notes	$ 29,083,237	Counterparty

Note 11 - Cash, Investments, and Fair Value Disclosure (Continued)

Interest Rate Risk - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The BWL's investment policy restricts investment maturities to a maximum maturity of three years. At year end, the average maturities of investments are as follows:

Investment	Fair Value	Less than 1 year	1-5 years
Pooled investment funds (if not 2a-7)	$ 15,509,230	$ 15,509,230	$ -
Mutual fund (if not 2a-7)	-	-	-
U.S. government or agency bond or note	32,052,606	8,966,626	23,085,980
Commercial paper	45,599,358	45,599,358	-

Credit Risk - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The BWL investment policy further limits its investment in commercial paper to prime quality by both Standard and Poor's and Moody's (A1/P1). As of year end, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Rating Organization
Pooled investment funds	$ 15,509,324	AAA	S&P
	6,190,411	Not rated	Not rated
Interlocal agreement fund	-	-	-
Mutual fund	-	-	-
Commercial paper	19,587,461	A1+	S&P
	26,011,897	A1	S&P

Note 11 - Cash, Investments, and Fair Value Disclosure (Continued)

Concentration of Credit Risk - The BWL's investment policy allows no more than 30 percent of the total portfolio to be invested in obligations of any particular issuer except the U.S. Treasury. As of year end, more than 5 percent of the BWL's investments are in various commercial paper as listed below. These investments represent 28.67 percent of the BWL's total investments.

Issuer	Amount Invested	Percentage of Total Investments
American Express Credit commercial paper	$ 5,781,555	5.73
Fountain Square commercial paper	5,980,839	5.93
General Electric Capital commercial paper	5,158,813	5.11
Sigma Finance commercial paper	6,311,804	6.25
Toyota Motor Credit commercial paper	5,700,103	5.65

Foreign Currency Risk - The BWL policy requires that all investments be in U.S. dollars. The BWL holds no investments in foreign entities, currency, or debt.

Note 12 - Estimated Liability for Excess Earning on Water Supply and Electric Utility System Revenue Bonds

In accordance with Section 148(f)(2) of the IRC of 1986, as amended, the BWL is required on each anniversary date (July 1) of the Water Supply, Electric Utility, and Steam Utility System Revenue Bonds, Series 1994B, Series 1999A, Series 2002A and B, 2003A, and 2005A to compute amounts representing the cumulative excess earnings on such bonds. That amount essentially represents a defined portion of any excess of interest earned on funds borrowed over the interest cost of the tax-exempt borrowings. Expense is charged (credited) annually in an amount equal to the estimated increase (decrease) in the cumulative excess earnings for the year. On every fifth anniversary date and upon final maturity of the bonds, the BWL is required to remit to the Internal Revenue Service the amount of any cumulative excess earnings computed on the date of such maturity plus an amount equal to estimated interest earned on previous years' segregated funds.

Note 12 - Estimated Liability for Excess Earning on Water Supply and Electric Utility System Revenue Bonds (Continued)

At June 30, 2006 and 2005, the estimated liability for excess earnings is $0 and $178,125 respectively. During the year ended June 30, 2006, the BWL received a recovery of overpayment from the United States Treasury of $184,101 under the arbitrage provisions on series 1989A and 1989B Bonds. In accordance with the requirements of the bond indenture, the BWL is required to set aside any current year additions to this estimated liability in a rebate fund within 60 days of the anniversary date of the bonds.

Note 13 - Enterprise Fund

The financial statements presented reflect only the financial statements of the Enterprise Fund of the BWL and do not include the assets, liabilities, equity, and operations of the Pension Funds and VEBA trust of the BWL. Management of the BWL has prepared these financial statements under such basis to facilitate the comparison of operating results with entities engaged in providing similar types of services.

Note 14 - Risk Management and Insurance

The BWL is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The BWL has purchased commercial insurance for certain general liability, business auto, excess liability, property and boiler and machinery, public officials and employee liability claims, and specific excess workers' compensation claims, subject to policy terms, limits, limitations, and deductibles. The BWL is uninsured for workers' compensation claims. Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

Note 15 - Changes in Accounting Principles

During the year ended June 30, 2006, the BWL elected the early adoption of GASB No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, to account for the Retiree Benefit Plan and Trust. All provisions of this new standard have been reflected in Note 8.

Note 16 - Subsequent Event

Subsequent to June 30, 2006, the BWL is considering the issuance of additional revenue bonds to finance certain capital improvements for approximately $35 million. As of the opinion date of the financial statements, no new debt has been issued.

Note 17 - Reclassifications

Certain amounts from June 30, 2005 have been reclassified to match the current financial statement presentation.

Additional Information

Income Available for Revenue Bond Debt Retirement

	2006	2005
Income - Before capital contributions per statement of revenues, expenses, and changes in net assets	$ 6,725,153	$ 7,134,027
Additional Income		
Depreciation and impairment	28,434,086	27,149,445
Interest on long-term debt:		
Notes	34,527	18,106
Revenue bonds	8,933,133	9,434,106
Total additional income	37,401,746	36,601,657
Income Available for Revenue Bonds and Interest Redemption	**$ 44,126,899**	**$ 43,735,684**
Debt Retirement Pertaining to Revenue Bonds		
Principal	$ 8,200,000	$ 7,857,999
Interest	8,933,133	9,434,106
Total	**$ 17,133,133**	**$ 17,292,105**
Percent Coverage of Revenue Bonds and Interest Requirements	**258**	**253**

	Combined		Eliminations	
	2006	2005	2006	2005
Operating Revenues				
Water	$ 24,566,856	$ 22,926,679	$ -	$ -
Electric:				
Retail	158,587,347	145,849,433	(516,952)	(516,952)
Sales for resale	37,382,001	39,721,968	-	-
Steam	8,352,271	15,417,432	-	-
Chilled water	4,710,920	4,590,671	-	-
Total operating revenues	233,599,395	228,506,183	(516,952)	(516,952)
Operating Expenses				
Production:				
Fuel, purchased power, and other operating expenses	120,521,530	116,956,631	(516,952)	(516,952)
Maintenance	21,419,482	19,377,525	-	-
Transmission and distribution:				
Operating expenses	7,910,435	7,207,118	-	-
Maintenance	7,626,854	7,651,885	-	-
Administrative and general	50,364,794	41,624,515	-	-
Depreciation and impairment	28,434,086	27,149,445	-	-
Total operating expenses	236,277,181	219,967,119	(516,952)	(516,952)
Operating Income (Loss)	(2,677,786)	8,539,064	-	-
Nonoperating Income (Expenses)				
Investment income	2,637,223	2,941,898	(162,609)	(226,162)
Other income	19,659,379	8,375,183	-	-
System capacity fees	9,381,224	9,330,849	-	-
Bonded debt interest expense	(8,933,133)	(9,434,106)	-	-
Amortization - Central Utilities Complex	(4,080,000)	(3,805,000)	-	-
Payment in lieu of taxes	(9,227,227)	(8,795,755)	-	-
Other interest expense	(34,527)	(18,106)	162,609	226,162
Total nonoperating income (expenses)	9,402,939	(1,405,037)	-	-
Income (Loss)	**$ 6,725,153**	**$ 7,134,027**	$ -	$ -

Detail of Statement of Revenues and Expenses
Years Ended June 30, 2006 and 2005

Water		Electric		Steam		Chilled Water	
2006	2005	2006	2005	2006	2005	2006	2005
$ 24,566,856	$ 22,926,679	$ -	$ -	$ -	$ -	$ -	$ -
-	-	159,104,299	146,366,385	-	-	-	-
-	-	37,382,001	39,721,968	-	-	-	-
-	-	-	-	8,352,271	15,417,432	4,710,920	4,590,671
-	-	-	-	-	-	-	-
24,566,856	22,926,679	196,486,300	186,088,353	8,352,271	15,417,432	4,710,920	4,590,671
6,373,012	6,001,312	107,127,354	101,704,838	6,276,021	8,669,785	1,262,095	1,097,648
2,610,311	2,408,869	16,602,022	15,082,216	1,860,583	1,623,239	346,566	263,200
1,317,225	1,465,518	6,407,612	5,590,355	185,095	146,466	503	4,779
1,977,997	1,666,290	5,231,230	5,507,289	417,240	469,950	387	8,356
9,749,813	6,290,938	37,215,850	33,685,467	2,941,803	1,648,111	457,328	-
4,688,627	3,643,934	19,986,313	20,137,725	1,919,586	1,646,379	1,839,560	1,721,406
26,716,985	21,476,861	192,570,381	181,707,890	13,600,328	14,203,930	3,906,439	3,095,389
(2,150,129)	1,449,818	3,915,919	4,380,463	(5,248,057)	1,213,502	804,481	1,495,282
354,596	531,584	2,153,592	2,244,231	180,473	185,268	111,171	206,977
1,225,550	1,212,424	18,144,555	7,154,843	289,180	7,916	94	-
821,795	817,382	7,844,580	7,802,456	714,849	711,011	-	-
(1,076,507)	(1,166,893)	(5,652,068)	(5,949,380)	(361,313)	(387,212)	(1,843,245)	(1,930,621)
(357,408)	(333,318)	(3,411,696)	(3,181,741)	(310,896)	(289,941)	-	-
(966,081)	(879,466)	(7,667,047)	(7,120,693)	(405,815)	(611,969)	(188,284)	(183,627)
(9,121)	(5,655)	(25,338)	(12,410)	(162,677)	(226,203)	-	-
(7,176)	176,058	11,386,578	937,306	(56,199)	(611,130)	(1,920,264)	(1,907,271)
$ (2,157,305)	$ 1,625,876	$ 15,302,497	$ 5,317,769	$ (5,304,256)	$ 602,372	$ (1,115,783)	$ (411,989)

Board of Water and Light - City of Lansing, Michigan

Detail of Statement of Changes in Net Assets

	Combined	Water	Electric	Steam	Chilled Water
Net Assets - June 30, 2004	$ 468,571,428	$ 94,603,515	$ 354,739,765	$ 19,228,148	$ -
Income before contributions	7,134,027	1,625,876	5,317,769	190,382	-
Net Assets - July 1, 2005	475,705,455	96,229,391	360,057,534	19,418,530	-
Income before contributions	6,725,153	(2,157,305)	15,302,497	(5,304,256)	(1,115,783)
Net Assets - June 30, 2006	**$ 482,430,608**	**$ 94,072,086**	**$ 375,360,031**	**$ 14,114,274**	**$ (1,115,783)**

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August 25, 2006

Finance Committee
Board of Water and Light – City of Lansing, Michigan
1232 Haco Drive
Lansing, MI 48823

We recently completed our audit of the basic financial statements of the Board of Water and Light - City of Lansing, Michigan Enterprise Fund (BWL) for the year ended June 30, 2006. As a result of our audit, we have the following comments and recommendations for your review and consideration.

Contingencies and Disputes

During 2006 we became aware of a matter associated with GM steam service where GM claims the BWL overbilled them for steam service as a result of a faulty meter. The BWL has estimated the overbilling to approximate $1.9 million. Apparently, the meter error was discovered in 2002 and operations was trying to resolve the dispute and finance was not fully aware of the magnitude of the overbilling or the circumstances surrounding the issue. As a result of the audit, the BWL recorded a liability and expense in the amount of $1.9 million as of June 30, 2006 related to this matter. We recommend management fully evaluate all financial matters related to disputed liabilities and potential contingencies to ensure their proper timely recording.

Management response: We agree that management fully evaluate disputed liabilities and potential contingencies. In the current instance, there is an offsetting receivable associated with other past billing errors and we are in discussion with General Motors to reach a comprehensive resolution of all metering and billing disputes. Management's belief is that the net result of the settlement will be immaterial to the BWL's financials. However, we also agree that it is appropriate to record the liability while awaiting resolution of the potential receivable. Consequently, a liability of $1.9 million was recorded in June's business.

Internal Controls – SAP

Subsequent to year end, the BWL began the implementation of a new software package. We would expect the implementation of the new SAP system to have a significant impact on current processes within the BWL – in both operation and financial reporting. As a result, the re-design of the internal control system at the BWL will be critical for the effective and accurate processing of financial and operational information. We recommend that management document and evaluate the process changes related to the internal control structure to ensure their proper design and implementation.

Internal Controls – SAP (Continued)

Management response: The new SAP system will undoubtedly have a significant impact on many of our current financial processes. All affected processes will receive a complete examination, which will include a thorough review of internal control requirements. Following redesign of the affected processes, extensive testing will be performed to ensure the new processes are operating efficiently and effectively prior to implementation.

Inventory Obsolescence Reserve

At year end, the BWL recorded a reserve for obsolete stores and production inventory in the amount of $400,000 as a result of discussions that occurred during the audit. The BWL does not have a formal process for evaluating and reserving obsolete inventory. We recommend the BWL develop a process for adequately reserving for potentially obsolete and slow moving inventory during the year.

Management response: Management has set up a reserve for obsolete inventory and during this fiscal year will develop a procedure to review obsolete inventory and annually adjust the reserve as needed. The reserve will be determined based on management's assumptions about the potential demand for emergency reserve production plant parts, any appropriate material expiration dates, estimated transmission and distribution construction and repair schedules, and future production and delivery operational plans.

Capital Assets

Indirect Cost Rates - The indirect cost rate used to capitalize internal BWL costs within capital projects has not been updated since February of 2004. Indirect rates typically are set using budgeted overhead costs in the current period or actual costs for the previous period. Capitalizing costs using a rate developed in previous years could result in inaccurate capitalization because of a changing cost structure. We recommend that the overhead rate be updated on an annual basis.

Management response: Management agrees that the indirect cost rate should be reviewed annually, and that currently does take place. If the rate does not fluctuate by more than a few percentage points the rate has not been adjusted. Management will begin to adjust the rate annually regardless of the percent change.

Capital Assets (Continued)

Asset Tracking and Depreciation - The current system for tracking fixed assets is very manual-based and a significant amount of records are not kept electronically. In addition, depreciation is being calculated using Excel. Capital assets represent the BWL's most significant asset and tracking those assets manually increases the risk for error and is not the most efficient process available. We recommend that the BWL utilize a software package to maintain, track, and depreciate their capital assets. We would expect that the new SAP software would be utilized to accomplish this recommendation. Careful consideration should be given to how the system is set up, asset descriptions used, whether a physical inventory of the assets should take place, whether barcoding could be utilized, how the internal control structure related to construction in process will change, etc.

Management response: The new SAP system has an Asset Accounting module that will be utilized to track all of BWL's fixed assets. This process will receive a detailed review of deprecation practices, physical inventory, internal controls, etc., to ensure that the BWL is following best practices.

Construction in Process - In our 2005 management letter we commented on what appeared to be a delay in the closing of numerous capital projects that remained in CIP for an extended period of time without significant activity. During 2006 the BWL made progress in evaluating open projects and closing projects with limited activity. We recommend the BWL continue its efforts in developing consistent evaluation procedures for CIP to ensure the proper recording of the transactions.

Management response: Management agrees and staff will continue to work with the engineering departments to develop procedures to ensure that the WIP is monitored and work orders are closed timely.

Custody of Checks

We observed that approximately 1,000 A/P checks and 7,000 payroll checks are kept on-hand in the financial services vault. We observed that the BWL accounts for the numerical sequence of issued checks on a regular basis, however, the vault is open during business hours and not closely monitored. This could lead to a situation where a check could be stolen, forged, and the fraud may not be discovered timely due to the quantity of checks on-hand. We recommend that if the vault is to remain open all day that the checks are locked up separately and only key individuals should have access to the checks.

Management response: Management agrees that additional security should be placed on the checks. A lateral file cabinet that locks will be utilized to house the checks. Keys will be given to the Supervisor of Accounts Payable and Supervisor of Payroll.

We would like to thank the BWL staff for their assistance during the audit. We appreciate the opportunity to serve as your auditors. If there are any questions about your financial report or the above comments and recommendations, we would be happy to discuss them at your convenience.

Very truly yours,

PLANTE & MORAN, PLLC

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Partner

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